

# Evolution and transformation of the Soviet elite<sup>\*</sup>

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Draft: April, 10, 2001

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## ***Introduction***

Radical social transformations are often represented as sets of policies that are consciously designed and implemented by selfless, benevolent - although probably ideologically biased - “experimenters.” Hence, titles of numerous books and papers referring to either “Soviet socialist experiment” or “Russia’s capitalist experiment.”<sup>1</sup> The main problem of transition is, therefore, to design an optimal path from one sets of institutional arrangements to another, given the structural gap between the two. Under this approach, institutional elements are a passive material of social construction - or destruction - and the studies in institutional inheritance have no relevance.

This is arguably not true even in the context of the most abrupt revolutionary change. Institutions do not exist per se, they are borne by people, economic - or in a broader setting, political-economic - agents who are selfish and rational. Whatever changes they opt to go for, they do it not for the love of abstract enlightened policies but to maximize their own objective functions. In addition, these agents are *boundedly* rational: their ability to collect and process information, i.e. to solve problems, is limited, and so is their possible speed of adaptation to new conditions. They acquire social and human capital – skills, beliefs, and patterns of behavior, as well as identity and reputation – through a lengthy process of socialization under “ancienne regime.” They bring this luggage into the brave new world, even if they arrive into it in a revolutionary-romantic manner, on a top of tank.

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<sup>\*</sup> This research is funded by the Hoover Institution. Primary sources used in this paper are available from the Hoover Institution Archives.

<sup>1</sup> The power of this convention is remarkable: for example, a book by Ronald Suny - an inherently *evolutionary* account of the Soviet and post-Soviet society - is nevertheless titled “The Soviet Experiment.”

We must also take into account heterogeneity of political-economic agents. In various societies few percent of population concentrates in their hands overwhelming majority of property, power, and human capital, and therefore they determine the allocation of economic and political resources. For Pareto (1966), elite is inevitable because of uneven distribution of ability among the members of society, and this is an essential element of general social equilibrium. For others, it is mostly a matter of distribution of political power – tradition originating in Michels' (1962) "iron law of oligarchy." An economic counterpart of this approach views the state as "proprietary," as an instrument of ruling elite to collect rents (Grossman 2000)<sup>2</sup>.

However different are the *modi operandi* of elites in various societies, performance of economy and polity in a *stable state* is by and large determined by institutional elements – beliefs, behavioral patterns – associated with elite members. This makes the study of elites an important issue of economic analysis (Temin and Brezis, 1999). Elites also determine the direction of economic and political *change* in transitional periods. The most important issue in this context is that of elite dynamics: the degree and particular features of continuity/change. Radical social change is possible only if incumbent elite is challenged by an alternative group aspiring elite position, and if it lacks sufficient power to defend its position (Pareto 1966). The depth of institutional change is then proportional to the degree of elite change, although, as we argue earlier, even a hundred percent revolutionary turnover of ruling elite does not renounce institutional inheritance.

In the respect of Soviet Union static aspect is well understood: Soviet elite - as it is or in connection with the policies of the Soviet state - has been studied extensively (Clark 1989; Farmer 1992; Rigby 1990; Rutland 1993; and others). Indeed, the Soviet Union seems to provide a natural ground for elite-oriented studies, since its ruling elite captured seemingly all major social functions within a framework of organizations, tightly linked by the intermediation of the Communist party. Dynamic aspect, as applied to the end of the USSR and Russia's post-communist transformation, has been, however, largely neglected. The studies of Russian elite are still scarce (see White and Kryshatanovskaya (1998) for a review); reflections on surprisingly high rate of elite continuity in post-Soviet Russia began to appear just recently<sup>3</sup>.

The lack of interest in Russian elite can be explained by the dominance of standard story of Russia's transition, which intimates that the breakdown of the Soviet Union brought to power a revolutionary government supported by the majority of population. This government broke up with the past and launched radical reform that gave way to new social forces: everyone who discovered appropriate talent became a businessman or a

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<sup>2</sup> In the classic works by Mancur Olson it is only dictatorship that is proprietary.

<sup>3</sup> A seven-page discussion of "nomenklatura revolution" in Russia in Tikhomirov (2000) is the most extensive treatment of the problem, known to present author.

democratic politician, etc. In this context, the government that is supposed to be selfless adherent of market economy, can be blamed for errors and the new decision-makers are “allowed” to have pitiful lack of experience, but no one, except for some retrograde partocrats, can be suspected in disloyalty to market and democracy. In general, Russian post-communist transition was regarded as an experimentation performed with best intent and driven by ideological preferences – in exactly the same way as Bolshevik transformation is often depicted.

In the early phase of transformation, this story seemed fit but now it makes explanations of Russia’s failure to reach presumed free-market target look too superficial: inept and corrupt bureaucrats drowned the reform. Current “re-statization” comes as an unpleasant surprise, while there might have never been any genuine “de-statization.” To come up with a more sound explanations, we must pose a question: who governs the transformation process. Did the old elite surrender and quietly leave the field for the new elite? If so, the new elite could not but bring something from its Soviet institutional baggage: what exactly and how did that influence Russian transformation? If not, and the old rulers still stay in command: what forced them to opt out of Soviet system and go for transformation? What is the nature and the limits of such a transformation which is – following Pareto - by no means revolutionary, but is a mere realignment of old elite. The answer to these questions will help to answer a more general question: whither Russia?

The paper proceeds as follows. Section 1 gives an overview of Russian data, related to the issue of elite continuity. Section 2 presents political-economic models that are used in Section 3 to interpret major trends in the history of Soviet ruling elite, and its choice made in 1991. Section 4 concludes.

### ***1. Elite change and continuity in post-Soviet Russia***

Against the background of the stories of the collapse of communism, break with the past, and public choice in favor of market and democracy, the most fascinating fact of post-Soviet reality is the high level of “survival” of Soviet elite and its successful adaptation to the changing political-economic environment. Continuity of elite, smoothness of transition from the positions in *nomenklatura* into the positions of wealth and power in ‘capitalist’ Russia, needs to be explained and allows, in its turn, to understand better the nature of institutional change that Russia has undergone during past decade.

A series of studies that started to appear in mid-1990s and became more numerous and better founded on source base show that the rate of survival of Soviet elite is between 60 to 80 percent depending on branch of industry or government. In 1994 the highest

survival rate was among regional administrative elite – 82%,<sup>4</sup> the lowest presence of former holders of nomenklatura positions was recorded among businessmen – 61% (White and Kryshstanovskaya 1998). Altogether 65 to 75 percent of former nomenklatura staff continued to occupy positions within the Russian post-communist elite of 1993, often moving across institutional boundaries. Majority of them retained old positions or occupied similar positions in government or the economy. Social profiles and educational attainment of pre- and post-1991 elites are very similar (White and Kryshstanovskaya 1998).

Turnover in the upper tiers of government has been very high, and this is what makes many observers underestimate the rate of elite continuity. Probably, numbers cited above also give downward-biased estimates: they are based mostly on sociological studies conducted in 1992-95, the period when retrenchment of Soviet elite in the new institutional framework was still underway (Kukolev 1997; McCarthy, Puffer, and Naumov 2000). This largest bias should be in case of business elite. Massive influx of young people in the initial stages of their nomenklatura careers (“*komsomoltsy*”) and professionals, who did not seek this sort of career at all (“*fiziki*”), into Russia’s “new economy” in perestroika period led to their momentary domination among the ranks of businessmen in early 1990s. Manager-dominated privatization decreased their share to 42 percent in 1994 and raised the share of businessmen with nomenklatura past to 61 percent (Kukolev 1997). Mid-1990s were also characterized by migration of regional elite from positions in administration into boards of directors of privatized companies. No recent data on the composition and origin of Russian business elite is available. We can make a reasonable conjecture, however, that in contemporary Russia, after the privatization that gave decisive *incumbency advantage* (Alexeev 1999), the proportion of recent newcomers into the ranks business elite should be very low.

Continuity on the personal level does not automatically imply the lack of structural change. Indeed, there is a number of apparent dissimilarities between Soviet and post-Soviet elite. New elite is individualistic, it is supposed to be founded on private property and personal responsibility. The old one was a sort of collective director of the country and was subject to the unified system of circulation known as nomenklatura. A characteristic feature of the Soviet bureaucracy was collective decision-making as a method of avoiding individual responsibility (Gregory 1993), and high level of cohesion (or “consensuality,” as Putnam (1977) puts it.) On the contrary, Russian political and business elite looks extremely competitive or at least uncoordinated: no large and stable political parties, lobbying groups, or industrial associations emerged in the 1990s.

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<sup>4</sup> Formally, majority of those came from the positions in Soviets rather than in Party committees. However, reading of current regional bosses’ bios shows that most of them prudently

However, development since mid-1990s shows clearly that there is much less liberal change. Legal enforcement of property rights is substituted with discretionary (and corrupt) political protection. Enterprises retain strong links with administration. Close relations between federal government and large corporations actually have never been significantly severed. Favoring large enterprises, coupled with the close relationships between the “oligarchs” and government officials, sets a basis for continuing massive state involvement in the economy (McCarthy, Puffer, and Naumov 2000). In the regional level, they are continually reinforced through various mechanisms of political-economic exchange like “shares for taxes,” licensing and protection of businesses, and – in opposite direction – by directors getting seats in legislatures with the votes of dependent enterprise employees (Lallemand 1999, Startsev 1999, and others). By mid-1990s independent business degenerated; every more-or-less successful business had some relations to political establishment (Kukolev 1997). To sum up, Russian elite is less individualistic and competitive than it may seem, although the network that binds it together is not organized formally, in a single party, and consequently it is more loose.

The last but far from the least important fact, characterizing the change of Russian elite in the course of post-communist transformation, is that it is currently much richer than in the late Soviet period, both absolutely and relatively. Although correct estimates of income and wealth distribution for Soviet time are difficult to obtain, it is clear that Russia moved in a decade from the dense crowd of the countries with moderate inequality (index Gini  $\sim 0.3$ ) to the right edge of the world inequality scale (Gini  $\sim 0.5$ ), and there is no sign that the process has stopped, much less has reverted. Only few Latin American and African countries exhibit higher inequality, and probably none could make such a fast “progress” in modern times. (World Bank 2000; Commander, et al. 1999). This development took place not against the background of fast economic growth: unlike Central Europe, there is no Kuznets curve in Russia (Aghion and Commander 1999). There is a considerable fall in overall real consumption. Therefore, transformation economy was used to redistribute wealth in favor of those who had been already wealthier before.

This brief summary of Russian facts suggests that lesser changes took place in Russia since the demolition of the USSR than it is often suggested. This is little surprise, since, as we have seen, reformed ruling elite mostly retained its position in economic management and government administration. People who had vested interest in a Soviet-type system, and who acquired their human capital (knowledge, patterns of behavior, beliefs) in the Soviet environment are not to be expected to rush into destruction of the basis of their well-being for the love of the game named “competitive market.” We still need to understand what was the actual name of the game the Soviet elite played, but it is clear that they won it: in the year of 2001 former Soviet elite enjoys wealthier and safer life in

underdeveloped Russia than they had a decade earlier in the still seemingly powerful USSR. Is it a lucky contingency or the result of rational – although not necessarily conscious – choice? The latter option has certain appeal for an economist. In the remainder of this paper, an attempt is made to give a theoretical description of the motivation of the choices made by the Soviet elite and the nature of change they brought about.

## ***2. Political economy of the Soviet elite***

Soviet ruling elite - a union of economic managers, political decision-makers, and all sorts of administrators, imbedded in a single huge organization, the Communist Party - can be considered at two different levels. First, we can consider relations between elite in its whole and the rest of the society. From this perspective elite looks as an integral and homogeneous political-economic entity, who uses the working population as its tax-base. There is no fundamental difference between this model of elite and “dictators” in other models. Then, if we “zoom in,” we see that the Soviet elite is far from homogeneous, even in the level of top Party leadership which has a close resemblance to a collective dictator, and this heterogeneity shows in some aspects of decision-making (Gregory 2001, Belova and Gregory 2001). The Soviet (or broader, a Soviet-type) elite is inherently stratified, and stability of its circulation rests on permanent upward mobility. Finally, we can see that the level of integrity of the Soviet elite varies over time and between functional branches of the elite. As we will show the level of integrity is tightly related to the vertical structure of elite, and both are responsible for major turns in the history of the Soviet elite.

In the following we draw up two separate model for each level. The first one treats elite as a single entity opposed to the population. The second is focused on the mobility into and within the elite and assumes internal heterogeneity of the elite.<sup>5</sup> The two models are compatible and work together to explain the evolution and transformation of the Soviet elite.

### **2.1. Elite versus population.**

Let's consider a society split into two internally homogeneous groups, unequal in size in functions: elite and population. The former can be thought of as an individual ruler. This multi-head ruler is self-interested and taxes the population to solve the only problem: to maximize his net revenue. Our ruling elite resembles “stationary bandit” (McGuire and

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<sup>5</sup> We do not consider here relations between the elite and its leader, a personal dictator, although the latter is an allegedly indispensable element of the Soviet institutional order: in the present context it is sufficient to assume that elite may need a dictator as an instrument of coordination under certain circumstances. See more on that in subsection 2.2.



Olson, 1996), departing from this concept in two important points: 1) ruling elite does not produce any public good; 2) it takes costly coercion to force population into paying taxes - there is no free lunch for the elite. The second modification logically follows from the first one: there is no incentive for the population to pay taxes. The first one may seem unrealistic: indeed, rare government produces absolutely no public goods. Moreover, it is in dictator's best interest to "produce" public law and order: by protecting his subjects from theft, he increases his taxable base (Olson 1995). Dictator also may choose to produce public goods in exchange for his subjects' loyalty (Wintrobe 1998). But it is exactly this selfishness that allows us to exclude public goods from consideration in a simple model: they "spill over" from the rulers' coercion effort rather than being purposefully (benevolently) produced at the expense of their profit. The way rulers "buy loyalty" of population will be discussed later.<sup>6</sup>

Essentially, model proposed here is a political-economic version of a simple market-clearing model, often used in contemporary macroeconomics. The main peculiar feature of this model is that agents are divided into two types: parasitic ruler-elite and working population. The latter produce the only generic economic good in this economy - "consumption"; the former coerces the latter to give away a part of their product to feed elite. Elite is capable of coercion because it produces private economic bad (instead of public good) - let's call it *harm* - that enters population's utility function with negative coefficient, and, therefore, harm has negative price. Population would like to give away a unit of their output (i.e. to reduce consumption) in exchange for some remission of harm, threatening it. Harm can be physical or moral, and we can assume that there exists finite level of harm that population can stand. To reduce the complexity of the problem, we assume that population always elects to pay off all the harm that the elite can do to it in a given state of the political-economic system (as opposed to choosing a mix of some harm and some consumption). Consequently, in the equilibrium no actual harm is made.

Elite's ability to produce harm is limited, since harm production is costly. Elite has to allocate a part of its tax revenue (obtained from population) to produce harm. Functional dependence between elite's input into coercion and maximal harm, this can yield, is given by "harm production function" (or coercion cost function):

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<sup>6</sup> Unlike Wintrobe (1998), who does assume that repression (as well as acquisition of voluntary loyalty of the citizens) is costly, our dictator-elite does not seek to maximize political power per se and no particular functional dependency between political-economic variables is presumed. It is similar to the model of "proprietary public finance" (Grossman and Noh, 1994) in that taxation is treated here exclusively as a ruler's method to create his income. These authors, however, set up a dynamic model to show that ruler will provide public goods in order to increase loyalty of his subjects and thus prolong expected stay in power.

$$H = H(I), H' > 0^7$$

There is no “special agents” in this political-economic system: harm is produced by elite itself, by all its members in equal proportion. Inputs in “harm production”  $I$  are the costs of military and communication technology, administrative costs, etc. – all what is needed to maintain repressive machinery.<sup>8</sup> Elite’s problem is to maximize its collective net revenue:

$U_e = R_e - I$ , where  $R_e$  is the amount of output (consumption) taken away from population.

Likewise, consumption good is produced by homogenous population by using a single input, labor (labor time or, more generally, work effort). This is given by a normal production function:

$$X = F(L), F'(L) > 0, F''(L) < 0$$

Population values leisure and, therefore, labor time (effort) is also an economic bad for them. Let’s assume population’s utility function is separable in its three components:

$U_p = X(C) - Y(L) - Z(H)$ , where  $C$  is consumption,  $L$  – labor,  $H$  – (potential) harm;  $X(C)$  is increasing in its argument and concave,  $Y(L)$  and  $Z(H)$  are decreasing and convex.<sup>9</sup>

For any given level of output (input of labor) and maximal level of harm that elite can produce, we can derive a schedule of consumption levels which population is willing to give away to avoid certain amounts of harm. Let’s call this a *resistance* function  $R(\cdot)$ . Essentially, it is an amount of harm that elite needs to be able to apply in order to lay a (credible) claim on population’s output  $R_e$ :  $H = R(R_e)$ . Other way, resistance function is the population’s demand for safe life (absence of harm).<sup>10</sup> Combination of resistance and “harm production” curves determine partial equilibrium in the consumption-harm space (Fig.1.)

<sup>7</sup> The assumption of diminishing returns to inputs in coercion could be reasonable but it is not necessary. For a non-trivial solution to exist, resistance and coercion curves need to intersect but no specific functional behavior is required.

<sup>8</sup> It is possible to treat our elite alternatively, as a ruler plus an army of hirelings. Costs of coercion  $I$  are then the payments to the army. This interpretation, however, does not fit well with extensions of the model that will be discussed later.

<sup>9</sup> Consequently, utilities of corresponding goods “leisure” and “no-harm” are increasing in their arguments and concave, as usual.

<sup>10</sup> Technically, it is an indifference curve in the  $(C, H)$  plane. An assumption that harm can be moral implies that preference for harm and, consequently, positions of resistance curves can be influenced by ideology. Thus, ideology is different from coercion in that it can be used by elite to *directly* influence resistance. We leave this effect out of present model for the sake of simplicity.



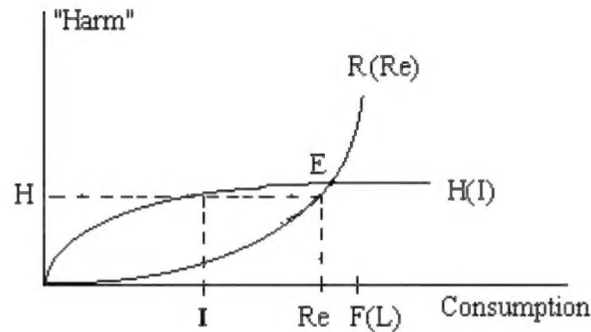


Fig. 1. How coercion works: resistance and "harm production."

Elite is able to produce harm  $H$  if investing  $I$  in coercion. Population is willing to pay off this harm by forgoing consumption  $Re$ . Thus, elite's net revenue is  $Re - I$ ; population's consumption is  $F(L) - Re$ , where  $F(L)$  is total output. Extreme attainable state of the system in Fig.1 is at point  $E$  where elite's gross revenue  $Re$  is maximized and net revenue is zero. Optimal (for the elite) level of coercion under the conditions plotted in Fig. 1 lies apparently below  $H$ .<sup>11</sup>

Since harm is by assumption always paid off, population chooses labor effort in the same manner as in other market-clearing models: by equating marginal rate of substitution between labor and consumption (MRS) and after-tax marginal return to labor effort (MRL). In general, the latter is not equal to the marginal product of labor  $MPL$ . For any given  $L$ :

$MRL < MPL$ , if taxation is proportional, i.e.,  $Re = tF(L)$ ;

$MRL = MPL$ , if elite collects fixed tribute (lump-sum tax), i.e.,  $Re = F(L) - T$ .

Optimal state of this economy is determined by simultaneous problem solving by elite and population, where population chooses labor effort given the size of tax, and elite chooses the size of tax in awareness of the population's optimal response. Ultimately, the size of tax (tribute  $T$  or the tax rate  $t$ , depending on what method of taxation is used) is the only choice variable in this coercion-based economy.

<sup>11</sup> Note that, unless resistance curves approaches vertical asymptote at  $F(L)$ , point  $E$  may lie to the right of  $F(L)$ , which means that the elite is capable of stealing the whole consumption, and thus killing the population inadvertently in the course of its experiments with various levels of coercion.

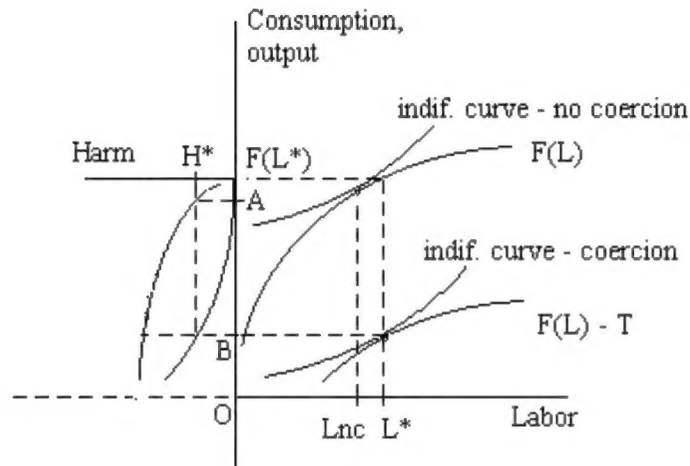


Fig. 2. General equilibrium in coercion-based economy.

General equilibrium in coercive economy with lump-sum taxation is represented in Fig. 2.<sup>12</sup>  $L_{nc}$  indicates labor chosen by population in the absence of coercion;  $L^*$  is equilibrium labor under coercion, where corresponding level of coercion is given by  $H^*$ . Left part of the diagram is essentially the graph from Fig. 1, inverted and rotated. Resistance and harm production curves originate from the point, corresponding to the total output  $F(L^*)$ .

In Fig. 2 rulers' investment of  $I = F(L^*) - A$  in coercion yields net revenue of  $(A - B)$ , while population consumes  $B$ . Note that the population is free to choose the level of labor effort, and this level is higher than that chosen in coercion-free economy (i.e. a society, free from parasitic elite.) It can be easily shown that  $L^*$  is always greater than  $L_{nc}$  under lump-sum taxation (which is equivalent to parallel downward shift of the production function,) while under proportional taxation the effect of change in tax rate on the choice of labor is, in general, indeterminate.

It is important to note that, in accordance with our assumptions, rulers' gross revenue is removed from the economy forever: no re-investment of whatever kind is made.<sup>13</sup> What we call "population's consumption" is, in fact, total gross revenue of productive economy

<sup>12</sup> We consider only lump-sum taxation here because the system of revenue collection, that was created by the Soviet rulers in the 1930s and remained essentially unchanged until the fall of the USSR, was equivalent to regressive taxation system with 100% taxation of inframarginal income (Olson 1995). This can be approximated as a lump-sum taxation. This system had a particular appeal for the Soviet rulers - at least as long as international competition was taken seriously - since it stimulated higher output.

<sup>13</sup> We know that Soviet elite was heavily involved in managing production. However, we do not model this aspect here, assuming that the elite took on managerial function only to extract revenue from the economy.

and, thus, includes investment in physical and human capital in addition to consumption proper. Therefore, the level of population's consumption sets the limits on attainable rate of growth in the economy. Elite may be interested in higher rates of growth, if it has long enough time horizon – as Olson's "stationary bandit" – to forgo portion of its current revenue in order to maximize present value of its future revenue. It has also a strong motivation to do so if it needs to "catch up" with competitors outside of the country.

Growth can be stimulated in two ways. Firstly, tax burden on the economy can be eased and consequently elite's net revenue will fall below (short-run) maximum. Secondly, in addition to coercive taxation, which causes relative "overwork," rulers may choose to coerce population directly to work more, i.e., to create a system of *forced labor*. The first option necessarily implies sub-optimal solution for the elite in the short run. The second option provides a broad scope possibilities, although it is not necessarily workable: forced labor not only leads to higher output but also causes coercion costs to grow, since resistance curve shifts upwards – population gets disutility of "overwork" even when it is not taxed (Fig. 3.)

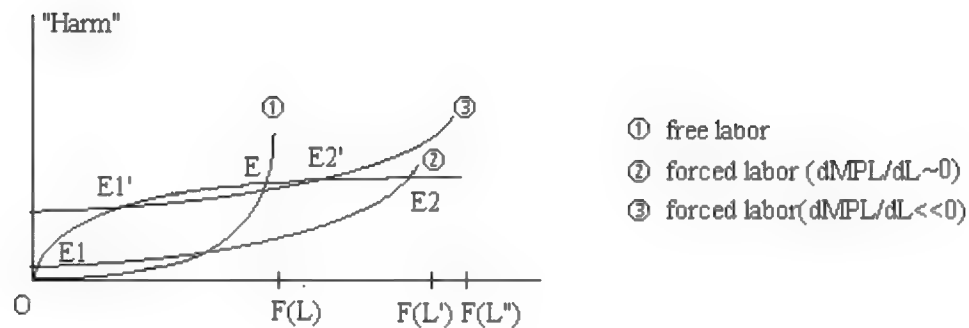


Fig. 3. Coercion and resistance. Free vs forced labor.

In the system with forced labor, elite is the only decision-maker, which sets both tax rate and labor effort. Economy is no longer in equilibrium ( $MRL \neq MRS$ ), although political-economic system in its whole is equilibrated by extra coercion expenditures. Whether elite is getting short-run benefits from the use of forced labor or not, depends on particular combination of resistance and harm production curves. The range of feasible solutions ( $E1, E2$ ) can be also wider or narrower than with free labor system. If the economy exhibits slowly diminishing returns ( $dMPL/dL \cong 0$ ), forced labor can be a superior solution for the elite in the short run, since an increase in the coercion costs is outweighed by the increase in overall production, to  $F(L')$ . However, there should be always some *positive* level of coercion in an economy with forced labor. An adverse shock

to coercion or resistance functions can move the system out of the range of feasible solutions (E1, E2). Also, this range gets narrower (E1', E2') as MPL decreases in an extensively growing economy ( $dMPL/dL \ll 0$ ): a small increase in output to  $F(L'')$  can be obtained by relatively large additional input of coerced labor. Therefore, if rulers stick to the use of forced labor, political-economic system may eventually reach a state beyond which further *smooth* evolution is impossible. In contrast, free-labor system can smoothly maneuver between zero coercion and maximal level at E.

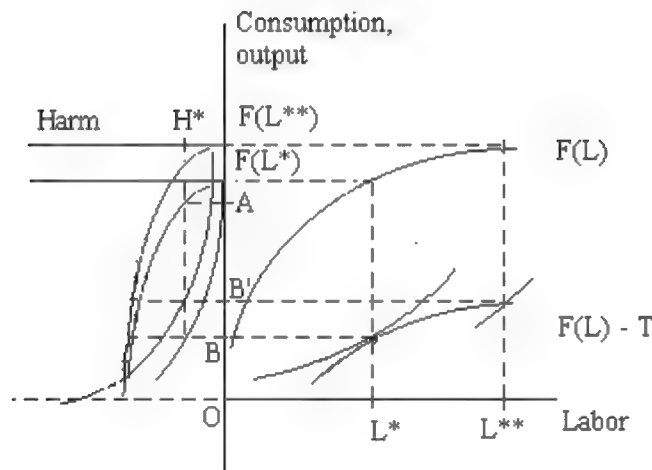


Fig. 4. Equilibria with and without forced labor.

Fig. 4. makes a juxtaposition of two equilibria: with free and forced labor –  $L^*$  and  $L^{**}$  respectively. Positions of resistance and coercion curves are artificially adjusted here in such a way that the level of coercion is the same in both cases –  $H^*$ . However, in the second case this is reached at a higher cost  $F(L^{**}) - A$ , while ruler's net revenue is lower  $A - B'$ . Note also that population's indifference curve under forced labor goes lower than under free labor, even though its consumption is higher. Thus, under conditions presented in Fig. 4, everyone is worse off in the short run. However, long-run optimization considerations which are not rendered by this model can make forced-labor solution of a sort presented in Fig. 4 attractive to the elite.

As we could see from Fig. 3, forced labor solution may become progressively less stable as the parameters of economy change, causing the range (E1', E2') to shrink. Whatever the elite's reasons to stick to the forced labor solution are,<sup>14</sup> it may evolve

<sup>14</sup> It is possible that change in system parameters create diverging paths leading from net-revenue maximizing point in a forced labor system (like one associated with curve 2 in Fig. 3):

towards an unsustainable state of political-economic system. In Fig. 4 this may cause eventually a jump from the type of equilibrium associated with  $L^{**}$  to that of  $L^*$ . It is noteworthy that if this happens both utility of population and elite's net revenue grows while output of the economy falls.

This type of behavior is largely similar to the collapse of coercive command economy as modeled in Harrison (2001a). In the latter model, however, dictator (or "the planners") abandons coercion whatsoever and, implicitly, ceases to exist, while in the present model only forced labor is abolished and political-economic system continue its functioning at a lower level of coercion. We will recourse to this theoretical possibility later, in Section 3, to interpret the choice in favor of transformation made by the Soviet elite .

## 2.2 Inside the Elite

Oppressive regimes always use some sort of political or economic devices to prop their repressive effort with voluntary loyalty of their subjects. Some political-economic models make provisions for this option (Wintrobe 1998, Grossman and Noh, 1994). The model, presented above, made a deliberate emphasis on the parasitic nature of ruling elite, and excluded the possibility for the elite to produce public goods to sell for political loyalty. However, this model can be extended to include purely material loyalty, which is a voluntary donation of some labor effort (or output) by (a part of) the population. Technically, such willingness to donate makes resistance curves more flat and, in case of forced labor, shifts them downward. It is important to maintain that the elite is a group of people, rather than a single all-powerful dictator, in order to be able to model this feature.

Acquisition of loyalty, in the sense introduced above, is possible for the rulers if they provide opportunities for upward mobility for the population. In other words, if they recruit new elite members from the population, they can establish a system, whereby potential entrants are willing to donate (additional) labor in exchange for the prospect of promotion. In the Soviet-type systems, ruling Parties - and nomenklatura system of appointment control, in particular - provide an institutional mechanism of awarding promotion "tickets" in exchange for loyal service.<sup>15</sup> This system is multi-layered. Position in each layer requires certain level of service, and gives in return certain benefits and chances to climb farther up the ladder. Let's restrict ourselves here to a simple two-layer model to focus on mass-elite linkage and to elucidate the main working principle of the system in its whole and its inherent problems.

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there are two local optimal points, differing in the level of coercion but equivalent in the outcomes for the elite. In such a situation, existence of a group within the elite that have a special vested interest in forced labor will cause a solution with higher level of coercion to be chosen.

<sup>15</sup> In many Third-world countries and, for example, in Russia in the reign of Peter the Great, army played much similar role. Imperial Chinese bureaucratic pyramid is another close historic analog to the Party.

Let's suppose that elite consists of two layers: "bosses" and "activists." Bosses get benefits **b**, population gets wage **w**, and activists – the most miserable category in this society – get the same wage **w** as population and provide additional services to bosses (or pay "dues") of value **d** in exchange for promise to be promoted into a "boss" position after **t** years of service. It is expected that every agent retires at age **T**, receiving a negligible "pension" afterwards. An individual decides to join the ranks of activists (at time **0**) if his expected net benefits on career-making path exceed income in a humble position of an ordinary member of working population:

$$b(T - t) + (w - d) t > wT$$

This yields a simple choice criterion:

$$d/B < T/t - 1, \text{ where } B \text{ is "elite surplus": } B = b - w$$

Each term in these equation should be treated as an individual expectation. Expectations of **b**, **t**, and **T** are naturally based on the information announced by the elite's "human resources department," while dues **d** and wages **w** are private knowledge.<sup>16</sup>

Elite circulation mechanism, as introduced above, allows elite to obtain additional revenue from population at zero cost in the short run. In fact, this is a loan which each

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<sup>16</sup> The same approach can be used to model internal cohesion of the elite - chain of loyalties within multi-layered elite - by assuming that promotion from any layer to the next one is given only to those who exert additional (above average effort), and thus for any promotion-oriented person benefits are lower than for one who chooses to stay at the achieved level forever. We should also take into account that every member of elite does some work for their common cause, which is paid for from coercion budget (denoted earlier **I** in the previous subsection), and gets some share of net revenue, so that the ratio of the latter to the former grows with the hierarchical level in the elite.

Basic assumption of this model - aspirants of elite positions bear costs that are redeemed later, after admission to the ranks of the elite – discriminates it from other recent models of Party in a Soviet-type system. Gershenson and Grossman (2001) treat admission to Party as immediate cooption to the ranks of elite. In their model, cooption is a substitute to "repression." Optimal ratio of cooption to repression is determined by their relative costs. The costs of cooption are borne by incumbent elite, since, it is implied, elite budget is fixed. Schnytzer and Sustersic (1998) in their study of socialist Yugoslavia assume that the party membership is a demonstration of loyalty which comes in exchange for the rents distributed to the population, and therefore, high numbers of the party members signify stability of the regime. Our model assumes different mechanism of exchange through the party, and consequently, party membership per se is not indicative of the regime strength.

Rank-and-file Party members are not necessarily the closest real world counterparts for model "activists." It was so before late 1930s, when the Party was small and substantial service was required from every member, while "passives" were systematically purged. Non-daring rank-and-file Party members of later period are out of this model completely, for they were just buying certain small privileges with their membership fees. "Activists," then, are the people in the entry-level nomenklatura positions, like a secretary of primary party cell or a factory manager, who bears a considerable burden of responsibility without being adequately rewarded.



separate member of the elite has to pay back at time  $T$ . The main problem with this mechanism is that it is not self-enforcing.<sup>17</sup> Let's think of an individual becoming an activist as signing an implicit contract with the incumbent elite. This contract is beneficial to both parties at time zero when the contract is signed. It is also beneficial for the elite *as a whole* to keep promises: if they do not retire at  $T$ , activists cheated on promotion will deny their loyalty; population's expectation of  $T/t$  will fall, so that less new activists will be hired; both effects will increase resistance and reduce elite's net revenue.<sup>18</sup> However, it does not pay for any particular member of the elite with narrow interest to keep promise to retire.<sup>19</sup> a member's benefit from staying one more year in office is greater than immediate loss from broken promise, unless the elite is very large and the economy is very poor.<sup>20</sup>

One way to mitigate the problem with "promotion contracts" is to entrust dictatorial powers to an elite member with an encompassing interest, that is, one who identifies himself with the objectives of the elite as a whole. He would be able then to use these powers to enforce "contract compliance" – members' retirement, as they reach announced end of tenure  $T$ .

In the absence of a dictator, the only limitedly viable solution for the Soviet-type elite is to arrange circulation in a fashion of financial pyramid: create new elite positions for activists whose "contracts" reach maturity, instead of casting incumbent members out, and hire yet more new activists to maintain political-economic balance. Obviously, this "Ponzi Party"<sup>21</sup> scheme can not work forever: only until the whole population is hired into activists. In fact, this ultimate boundary is never reached. Elite will get disinterested in supporting promotion system when opening a new elite position causes net revenue per

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<sup>17</sup> Problem, described here, is not dissimilar from those arising in labor markets. See Carmichael (1989) for a review of literature on incentives and self-enforcement in implicit labor contracts.

<sup>18</sup> In fact, cheated activists are likely to demand redemption of their deferred resistance. If the incumbent elite fails to propose a sort of "refinancing" of its debt, then momentary shock to the resistance curve follows.

<sup>19</sup> Passing the position of elite member on to an offspring is equivalent to refusal to retire, if we consider an elite family as a unit of analysis. Hereditary elite can be thought of as a never-retiring infinitely-lived dictator. This sort of elite is obviously unable to employ Party's method of borrowing loyalty.

<sup>20</sup> In a multi-layer elite, members of higher ranks has greater ability to stay longer in office than promised, because they have less pressure from above, and small sizes of higher layers make it easier to establish mutual-protection networks. In other words, formation of cliques leads to "clogging" of promotion channel and to the fall of promotion rate below expected.

<sup>21</sup> Present author learned recently that American journalists have reserved the term "Ponzi Party" to label proponents of an idea to save Social Security by increasing immigration. (O'Sullivan, John. "Ponzi Party." *National Review*; August 30 1999.) Indeed, the essence of the proposal looks similar to the scheme described above.

elite head to decrease, and this decrease is no less than the loss from the shift in resistance, incurred by the breach of promotion contract.

In reality, both forced retirement and pyramidal loyalty borrowing can be combined to slow down the decay of a Soviet-type elite circulation system. When the limit to elite growth is nevertheless reached, either an institutional change that reforms elite circulation system will follow or the incumbent elite will be overthrown by an alternative elite, which will most likely come from the most unhappy part of the population - cheated activists.

Let's now look at the Soviet-type elite from the Paretian perspective: as a top  $N$ -percentile of a society's distribution of ability. It is most likely that an alternative elite, seizing power through a revolution, is superior to conquered population in their abilities (at least after their rivals have been executed or forced into emigration). They certainly must dominate in their harm production capacity. The process of elite recruitment should guarantee that the elite is not becoming less efficient, that is, that there is no adverse selection of activists. However, Soviet-type loyalty borrowing is not free from adverse selection problem. Indeed, incumbent elite is interested in selecting those willing to yield higher level of dues  $d$  and high productivity in coercion. However, entering elite service is most attractive for those who has low abilities and consequently low expected wage  $w$ ,<sup>22</sup> and/or for those who has greater ability to cheat supervisors by bringing lower dues than he pretends. Neither abilities of activists, nor the true level of dues are perfectly verifiable. As a consequence, Soviet-type elite inevitably loses its position on the right tail of ability distribution with the course of time. Elite degeneration is amplified if growing economy provides more and more attractive "outside options" (such as higher salaries and benefits in academia, retail trade, etc.) for able members of population.

Summing up, a Soviet-type elite in the absence of a dictator inevitably grows larger, older, and less apt over time. The rate of elite degeneration depends on the degree of its integration. Absolute dictatorial rule that provides for maximal integrity can hinder adverse tendency but it lays additional costs on the members of the elite.

In present context, dictator plays essentially the role of intra-elite police, enforcing rules and promoting coordination in coercion effort. First, as it was pointed out above, a dictator is able to keep elite from explosive growth. Second, dictatorship can increase coordination by punishing free-riders among elite and, consequently, increase productivity of coercion. Third, dictator as a "stationary bandit" can limit the appetites of the elite, thus allowing for higher rates of growth or at least precluding exhaustion of the elite's tax base. Fourth, dictator can maintain a system of "fair" distribution of benefits, preventing wasteful competitive rent-seeking within the elite. The three latter functions of dictatorship are beneficial for all elite members who choose to coordinate but the first one

is not. Every member of an elite, coordinated by a dictator, bears shadow costs incurred by forced retirement. These costs are additionally increased by the principal-agent problem in the relations between elite and dictator: dictator by definition cannot be controlled and can become a “disloyal patron” like Stalin (Rigby 1990).<sup>23</sup>

For these reasons, dictatorial solution is more likely to emerge when high level of coordination is a necessity for the elite: in poorer societies (where taxation causes, other things equal, higher resistance), or when the elite needs for some reason (e.g. expected war) to increase the level of taxation and/or economy’s output considerably. The lower is the resistance of the population and the lower is the threat to elite rule the more likely it will choose less coordination. This will yield lower revenues for the elite as a whole but will be less restraining for the individual elite members. It was shown earlier that this will lead eventually to a crisis in the elite circulation.

### ***3. The choices and evolution of the Soviet ruling elite: a brief course***

Soviet history starts with the seizure of power in the capital of Russian Empire by a small and coherent group of revolutionaries, an alternative elite grown up on the margin of privileged society. They were enthusiastically supported by near-anarchic mobs throughout provincial Russia. Uneasy alliance of “federal” and “regional” Bolsheviks constituted the first version of Soviet elite. It fits our model in the most straightforward way: total nationalization effectively laid claim for the total output of Russian economy but almost no attempt was made to manage production; the only noteworthy activity of the new elite was in the sphere of coercion. “Invention” of lump-sum taxation and forced labor comes soon after Bolshevik takeover, although the system of institutionalized forced labor did not reach full blossom until much later (despite all the effort by comrade Trotsky).

Turbulent infancy of the Soviet elite - the “War Communism” - can be seen as a disequilibrium resulting from Bolsheviks making tax claim which was well above optimal and above what the population believed to be consistent with the new elite’s coercion capabilities. It was quite natural for the population to underestimate Bolsheviks’ harm-productivity: it was by the orders of magnitude higher than that of the Empire, let alone Provisional government. As the result, some of the “available” harm was left unpaid and an outburst of violence followed - recall: no actual harm is done in equilibrium - which led to a contraction of output beyond any theoretical predictions.<sup>24</sup> Excessive tax burden was

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<sup>22</sup> Even though different skills are required for production and coercion, ability for both are correlated: coercion does not mean the art of torturing only; being smart is also important.

<sup>23</sup> Costs are especially high if the “retirement procedure” is performed by NKVD.

<sup>24</sup> An alternative explanation can be that Bolsheviks in the first months of their power were “endowed with a stock of harm” accumulated by embittered Russian army. This stock was so large that the new rulers were able to claim revenue exceeding the total output of the economy, which

probably not a deliberate policy choice but a consequence of uncoordinated narrow-interest foraging. In 1921 the system was equilibrated, on the one hand, by setting lower level of taxation, as well as changing the system of taxation to proportional, and, on the other hand, by cracking down on rioting peasantry and Navy, which left no more doubt in the Bolsheviks' productivity in coercion.

Characteristic feature of WC period is very loose internal structure of the elite: extreme external threat helped to integrate the elite without much enforcement by the Party leadership. Extensive growth of elite ranks caused little conflict within the elite, since new positions were coming for "free," on the expense of overthrown elite and population. Early Soviet elite was "Soviet" indeed in the sense that it was embedded in the institution, inherited from the transitional year of 1917: confederacy of Soviets. Communist party was gradually losing its resemblance to a party of democratic polity. By the early 1920s – with the creation of *nomenklatura* elite-circulation machine, which is honored to comrade Stalin – it became the primary institutional framework for the Soviet elite. Until late 1920s this system had low throughput, opening way up for a relatively small number of graduates of Communist universities, Party schools and other branches of "Red Ivy League", who were filling the positions created by the growth of the economy and natural demise of "Old Bolsheviks."<sup>25</sup>

Situation changed dramatically in 1928 under joint action of three forces: expected slowdown after the limits of reconstructive growth were reached; growing war expectations;<sup>26</sup> insufficient (below expectations) benefits for the elite newcomers who paid high "dues" by their service in Red Army during the Civil War. Logical (for this system) response was to increase tax, returning to easier for monitoring lump-sum taxation. Turn to outright dictatorship was one factor that allowed the Soviet elite to perform extreme "tax reform," as planned, and survive. Another one was rapid acceleration of "loyalty borrowing" process, reflected by sharp increase in party membership and various forms of promotion (*vydvizhenie*). Creation of vertically-integrated system of revenue collection (known as "planned economy") increased productivity of coercion;<sup>27</sup> promise of fast

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meant destruction economic units, especially in industry. As time was passing free supply of harm to Bolsheviks was vanishing but taxable economy was shrinking as well. The bottom of this Maelstrom of excessive coercion and economic destruction was hit in early 1921.

<sup>25</sup> Although retirement was not rare among the older generation, it was not actually retirement in the model sense. Generous "retirement plans" left formally retiring elite members in elite with all benefits that accrued. Thus, "Society of Old Bolsheviks" was endowed not only with rest homes but also with factories.

<sup>26</sup> See Harrison (2001b) on the effect of "War Scare" of 1927 on the Soviet industrial policy.

<sup>27</sup> There was a significant variation in the propensity to coordinate among Soviet elite in late 1920s and early 1930s, the lowest being among local power cliques. Stalin was apparently a representative of those who chose to coordinate within a vertically-integrated organization but he

upward mobility for millions caused resistance curve to shift down.

In 1933 political-economic system required new equilibration. This time massive “breach of contracts” by elite was undertaken for the first time: purges that started in 1933 were targeted against newcomers to Party, whose pressure for elite positions might have become excessive - in three preceding years party ranks grew more than twice. Party members in the countryside, whose loyalty was in the highest demand during the years of collectivization, were purged disproportionately high when the “payday” came.<sup>28</sup> The single most widespread accusation was “passivity” – about one quarter of purged - that is, low “dues” in terms of our model.<sup>29</sup> By November 1936 the point was reached when further contract violation could have damaged political-economic balance beyond repair.<sup>30</sup> Dictatorship had become sufficiently strong by that time to initiate a massive campaign of “forced retirement” which became known as the Great Terror. A number of facts suggest that its main purpose was to let the activists acquire elite positions that they had “earned” by a decade or so of loyal service.<sup>31</sup> First, there is no any clear pattern in the incidence of Terror except for the hierarchical rank of the victim.<sup>32</sup> Second, the primary engine of elite

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also had to seek support of regional bosses in the struggle for the positions in the government (which was ideologically wrapped in the struggle against the ‘Right Deflection’).

<sup>28</sup> Expulsion rate in 1933 was 29% among collective farmers and 46% among individual farmers. Compare this to 10% in party apparatus, 12% among professionals, and 17.5% among industrial workers. (RGASPI. 17. 7. 309. 140)

<sup>29</sup> Possibly, the original idea of Party leadership was to direct the purge of 1933 against “shirkers” at all ranks in the Party. This was to be achieved by staffing purging commissions with rank-and-file communists, rather than local party bosses (Getty 1985). This declaration was either hypocritical or unenforceable: archival materials show that purge commissions consisted mostly of district and region level party leadership. (RGASPI. Reports on the progress of the purge. 1933...) Judging by the fact that admission of the new members to the Party was suspended at the same time, the real idea behind the purges was indeed to “declare default” by purging claimants of elite positions.

<sup>30</sup> Although 30 percent of party new entrants of 1929-32 had been purged by that time, remaining 1.2 mil. members of that cohort still constituted the majority of the party (72%), one third of them being stuck in inferior ‘kandidat’ position for 4-7 years. (RGASPI. 17. 7. 379. 47-51.)

<sup>31</sup> The Great Terror was, of course, a multidimensional process: no outstanding historical event can be explained by a single cause. In any case, explanations of the Terror as Stalin’s crackdown upon his political enemies, or inept administrator’s and managers, etc. cannot be sufficient since this sort of repression was persistent in 1920-30s. Two thirds of accusations in 1937-8 were just abstract “enemy of the people,” while the share of specific political accusations (oppositionist, former member of another party, etc.) was negligible. On the contrary, in the period of 1933-6 these specific political crimes accounted for a substantial share of expulsions from party and almost one half of all dismissals of regional level nomenklatura. The share of “economic crime” remained relatively stable throughout 1930s. (RGASPI. 17.7.309.27-31 and other data.)

<sup>32</sup> Studies, collected in Getty and Manning (1993), present the most systematic estimates of the incidence of the Terror. They were unable to discover strong patterns of any kind. No evidence that the Terror was targeted against “Old Bolsheviks.” Getty shows that Civil war entrants among

turnover was “democratization of Party”: in the election meeting in 1937-8 rank-and-file party members were given freedom to criticize their bosses and nominate candidates to replace them.<sup>33</sup> Recurrent theme in party press of 1938-9 - blaming uncovered “enemies of the people” in the regional committees for obstructing promotion of “young cadres” – is consistent with the “democratization” drive of the Terror. Additional indirect evidence to support this is the fact that the Terror was stopped in 1939 when a huge financial injection inflated local party budgets almost twice.<sup>34</sup> Since the role of party organizations in economic management and political control was declining at that time, this can be explained only as a massive repayment of overdue debt to activists, admitted mostly during the industrialization. This appeared to be a sufficient stimulus to stop rebelling.<sup>35</sup>

The use of forced labor was institutionalized at about the same time, in 1939-40, by coincidence: it was dictated by the necessity to further stimulate production in the eve of coming war. Although harsh labor laws adopted at that time were never systematically enforced,<sup>36</sup> norms and practices enforcing labor existed until the last years of the Soviet regime. Gulag was only a small and short-lived part of the Soviet system of forced labor. The most important was omnipresent indirect forcing made possible by aggregating ownership of capital, political power, and law enforcement in the hands of unified elite; and by subordinate position of labor unions.<sup>37</sup>

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top elite were relatively more likely to be victimized finds support in the archival data for the Party in general (RGASPI. 17. 7. 379. 47-51). This is likely to be a reflection of the fact that this cohort held the majority of elite positions in mid-1930s (46% in the regional level in 1933; RGASPI 17.7.229.49).

<sup>33</sup> The wish of unsophisticated activists to get promotion was so strong that in many district committee elections majority of electors were nominated to the positions in the party committees. (RGASPI. Report on the party committees election of 1937...) In this framework, the role of NKVD seems to be restricted to perform the “cleanup” of positions (as well as *zhilploshchad*) of fired elite members. However, special interest of NKVD might have played a considerable role in the extent and incidence of the Terror.

<sup>34</sup> This huge increase was mostly obtained through a subsidy from the governmental “reserve fund.”(RGASPI. 17.75.1.1-12. VKP(b) budget for 1939.) Reserve fund was typically used to mend state budget and to finance extraordinary investment projects. Thus, payment to party activists was essentially an additional tax on the economy.

<sup>35</sup> Free Party election were taking place until 1941. Although they were mainly under control since 1939 they sometimes did bring surprises such as casting out Saratov NKVD chief from regional party committee. (RGASPI. Report on the party committees election of 1940...)

<sup>36</sup> Although “breakers of labor discipline” account for one third of expulsions from the party in the second half of 1940 (RGASPI. 17.7.309.27), party inspectors complain that the number of unauthorized changes of workplace grew in comparison to the time when they were not prohibited ().

<sup>37</sup> Isolated industrial settlements provide the environment in which labor can be forced indirectly most efficiently: in a Yakutia gold mine everyone – free or inmate – has to work on the conditions set by local all-powerful administration. The situation in a village near Moscow was not much different before farmers were given internal passports in 1960s.



The system, created in 1930s, existed without fundamental change (despite a number of attempted reforms) and in basically unchanged environment until 1980s. Gradual change, however, did take place, the most pronounced trend being diminishing integrity of the elite. Resulting effects were: falling productivity of coercion, falling tax rate, ever growing pyramidal borrowing of loyalty.<sup>38</sup> Soviet elite entered 1980s with a burden of debt to activists on the verge of bankruptcy. Andropov and – after a short break – Gorbachev restarted the practice of forcing high-ranking party members into retirement. The activities of the latter reached by the end of 1980s the point where they must have become scarily similar to the Great Terror for the elite: increasing mobility, democratization, de facto abandoning of the Party by its leader in favor of the position of the head of government (only Stalin became the chairman of the Council of Ministers, while Gorbachev chose to become Comrade President), and, the last not least, shift of balance in favor of vertically-integrated system (away from regional cliques who dominated under Khrushchev and Brezhnev).

These policies, however, had virtually no impact on the activists awaiting for rewards for a decade or decades. The main beneficiaries of Gorbachev revitalization of elite circulation were “young cadres” who had actually come to the positions of “second” and “deputy” in their forties and fifties. Activists and lower-level elite members were proposed a generous outside option in late 1980s in the form of freedom of small enterprise and lift of restrictions on the size of salaries in the state sector. Apparently, to relieve the pressure on elite from below, the size of this tax cut should have been large enough with a clear consequence for the elite revenue. Additionally, switching off the Party loyalty-making machine meant upward shift of resistance curves, which could lead to complete disappearance of coercive equilibrium and hence to the disappearance of the elite. No option was left for the elite but a thorough institutional change that would bring the system to a different equilibrium.

In 1990-93 the system underwent fast transition of the sort discussed in subsection 2.1, involving momentary abandonment of forced labor and liquidation of the elite circulation system based on loyalty borrowing, that is, the Party. Result was that of contraction of economy’s output and consumption of the population, increase in the net revenue of the elite and the utility of population. The “loyalty borrowing” model explains why and how party machine stopped working. It does not explain why Soviet elite’s integrity was broken and why it became much more competitive (less unite) than it had been before. In other words, why privatization? An alternative way to protect from pressure from below could have been a collective defense, transformation into a closed

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<sup>38</sup> From 1950s to early 1980s there were no considerable purges of either activists or retirement-age elite members, and the size of both categories grew considerably. Upward mobility became notoriously low in the 1970s (Farmer 1992, Clark 1989).

caste. Here institutional inertia comes into action in the form of ideological norms: it was impossible for the Soviet elite to declare outright that from this moment on its ranks are closed from intrusion by newcomers forever – population would not accept that. It was much easier, however, given the state of public opinion, that the USSR was going to join the happy ranks of the nations accepting private property.

Privatization was thus the only feasible transition solution, and it also became a final round in the Ponzi party game: it was essentially a declaration of bankruptcy and auctioning off all elite positions. The auctions was not fair: incumbents were given priority in the form of information, power, relations, etc. However, it gave a chance for lots of new and old activists. Some of them won nice lots, others, who lost, had no reasonable ground to complain. Some of those who won successfully blended with the old elite, others were eventually squeezed out.

Privatization secured Soviet elite revenues by converting the rights of office into property rights. But it also unleashed competitive rent-seeking which reduced coercive productivity of the elite as well as productivity of the economy because of disorganization - rent seeking is a negative-sum game (Tullock 1980). In this sense, it was a coordination failure determined by past institutional development. First-best path of transformation for Soviet elite was not available because it was blocked by ideological constraints. However, excessive coercion had been apparently so large in the USSR that the choice to remove it allowed the elite to survive and even reinforce its position despite the inferiority of the overall outcome.

#### **4. Conclusion**

We have seen that the abrupt - and unexpected by the majority of observers – institutional change that put an end to the Soviet Union is consistent with the modus operandi of the Soviet elite. It can be explained by the same political-economic model that explains major choices it was making throughout the seven decades of its history. It is, therefore, quite natural that the Soviet elite took the lead in dismantling some parts of the Soviet institutional system and was “rewarded” by smooth transition and improved position in post-communist Russia.

It is clear now how wrong were those designers of reform who believed that they could come and write new rules on the “tabula Russia,” and old elite would silently bow to hypothetical forty million of new private owners. It appeared that Soviet elite was strong enough to keep hold on power and rational enough to choose privatization as a method to preserve this power and legitimize the new form of it. In principle, this does not look as a problem per se, as long as the main purpose of privatization, as Boycko et al. (1995) suggest, was to break the nexus between managers and politicians. It may seem that it does not matter where does the new class of capitalists comes. Unfortunately, it is not so.

Political-economic habits of the elite that was brought up within the Soviet institutional framework, and specific human capital it has accumulated, makes it unfit for market economy. The only order the “soldiers of Party” cannot execute is to become competitive entrepreneurs. They used to live in the world where coercion was indispensable and they successfully recreate it under new emblem. Dense networks of intertwining political controls and industrial interests, characteristic of contemporary Russia, can be seen as a re-implementation of the Soviet political economy of coercion.

Judging by current direction and rate of institutional change, Russian transition is in general over. Mr. Putin also repeatedly assures us that this is so: there will be no further redistribution of positions and the “vertical axis of power” is restored. Whatever one calls the destination point – “industrial feudalism” (Breslauer, et al. 2000) or anything else – it does not look like free market and democracy. It looks like one more step in the evolution of the Soviet regime, and there is no apparent reason why this regime cannot be stable: Political-economic equilibrium of “protection for services and taxes” - is inferior but it is self-sustaining: it does not pay businessmen to play “fair competition” under predatory government, nor it pays the government to abstain from regulation if producers practice anti-competitive schemes. Elite successfully evolves into a stable state of a true caste through a perfectly “civilized” monopoly on access to education, which is priced prohibitively high for the majority of Russian population. Population, however, has no reason to rebel as long as the economy grows faster than the population (which is not difficult when the population is contracting) and tax burden does not grow. Under stable external conditions this system can persist forever, but there is little hope that this system is capable of growth needed to meet the challenges of changing conditions.

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